No. 12,296

In the United States Court of Appeals for the Ninth Circuit

E. R. GOOLD, PETITIONER

v.

COMMISSIONER OF INTERNAL REVENUE, RESPONDENT

ON PETITION FOR REVIEW OF THE DECISION OF THE TAX COURT OF THE UNITED STATES

BRIEF FOR THE RESPONDENT

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OPINION BELOW

The memorandum findings of fact and opinion of the Tax Court (R. 34-52) are unreported.

JURISDICTION

This petition for review (R. 59-65) involves federal income and victory tax for the taxable year 1943. On June 5, 1947, the Commissioner of Internal Revenue mailed to the taxpayer a notice of deficiency in the total amount of $18,632.28. (R. 12-24.) Within 90 days thereafter and on June 30, 1947 (R. 1), the taxpayer filed a petition (R. 4-11) with the Tax Court for a redetermination of that deficiency under the provisions of Section 272 of the Internal Revenue Code. The decision of

the Tax Court modifying the deficiency was entered March 28, 1949. (R. 52-53.) The case is brought to this Court by a petition for review filed June 24, 1949 (R. 59-65), pursuant to the provisions of Section 1141 (a) of the Internal Revenue Code, as amended by Section 36 of the Act of June 25, 1948.

QUESTIONS PRESENTED

1. Whether taxpayer's share in the net income of a partnership between him and his father was his community or separate income. This in turn depends upon a determination of whether taxpayer received his interest in the partnership from his father by way of sale or by way of gift.

2. Whether taxpayer's accrued California income tax on his income from the partnership business was deductible in computing his income subject to the victory tax.

STATUTES INVOLVED

The pertinent statutes involved are to be found in the Appendix, *infra*.

STATEMENT

The facts as found by the Tax Court (R. 36-44) may be summarized as follows:

At all times material to this proceeding taxpayer was a resident of Stockton, California. His tax return for the year involved was prepared on a calendar year accrual basis. He reported his income and deductions on the community property method. (R. 36.)

On January 2, 1943, taxpayer and his father, R. Goold, entered into a partnership under the firm name of R. Goold & Son for the purpose of operating a business which taxpayer's father had theretofore conducted as a sole proprietorship. On that date the father executed a bill of sale purporting to transfer to taxpayer an undi-

vided one-half interest in all of the former's business assets described in the document, as follows (R. 36-37):

A. Eddy Electric and Mechanical Company. Assets valued at	$32,560.83
B. An undivided one-half interest in the R. Goold and A. E. Downer joint venture as shown upon the book of accounts	51,496.04
C. An undivided one-half interest in the R. Goold and F. R. Zinck joint venture as shown upon the book of accounts	$10,115.09
D. An undivided one-half interest in the R. Goold and A. R. Liner joint venture as shown upon the books of accounts	2,500.00
E. An undivided one-half interest in the R. Goold and C. L. Wold joint venture as shown upon the book of accounts	25,000.00
F. An undivided one-half interest in the "Marysville" Contract as shown upon the book of accounts	40,000.00
Total	$161,671.96

The property so described was owned prior to the transfer by the taxpayer's father and mother as their community property. In addition, they owned other community property of a value in excess of $83,000. They were the parents of another child, a daughter, who was two years older than taxpayer. (R. 37.)

The recited consideration for the transfer of the one-half interest was the execution and delivery by taxpayer of a non-interest bearing note in the amount of $100,000, payable at the rate of "twenty-five (25%) per cent or more of the annual profits which shall be made to and received by me out of the operation of said business." (R. 37.)

At the time of this transaction with his father, taxpayer owned a small home, an automobile, and four shares of stock of the Union Oil Company. (R. 38.)

Item A of the bill of sale represented the value of the assets of the Eddy Company, which was engaged in the business of the installation of wiring systems and the sale of electrical materials, supplies, and appliances.

Items B to F, inclusive, consisted of the known and estimated share of the profits of taxpayer's father in certain joint ventures for the performance of various Government contracts in the general area of Stockton, California. Taxpayer's father received his share of the profits in each of the joint ventures primarily for undertaking the responsibility of financing them in whole or in part. Such financing as was necessary had been arranged and completed by taxpayer's father prior to January, 1943. The accounting and handling of money for the joint ventures was done in the office of taxpayer's father in order to safeguard his interests in connection with their financing. (R. 38.)

The documents incident to the January, 1943, transaction were drafted and the terms and conditions determined by Lafayette J. Smallpage, an attorney, by whom, together with Frank Scott, an accountant, the entire arrangement was devised, after consultation with taxpayer's father. The attorney determined that the face amount of the note should be in the sum of $100,000, that no interest should be payable, and that the manner of repayment should be as recited in the note. (R. 38.)

The note contained the following endorsements on the back, all being in the handwriting of the attorney except those for 1944 and 1945, which were in the handwriting of the accountant (R. 39):

12/25/43	Gift	3,000.00
12/31/43	Credit by Error made in Computation of Value of Interest Sold	50,000.00
	Changed per authority of Smallpage 1/17/47	29,259.00
12/25/44	By gift	3,000.00
12/25/45	By gift	18,000.00
1/25/47	Earnings for 1945	7,107.42

At the time of the execution of the note and the bill of sale it was understood between taxpayer and his father that items E and F on the bill of sale, totaling

$65,000, were round figures representing as estimate of the father's share of the profits in the so-called Wold joint ventures, and that the figure would be subject to adjustment when the profits were known, with a corresponding adjustment to be made on taxpayer's note. (R. 39.)

The corrected figure was determined to be $44,810.04, which involved a decrease of $20,189.96, one half of which in the amount of $10,094.98 was included in the adjustments endorsed upon the note on January 17, 1947. That endorsement was in the sum of $29,259. (R. 39.)

Both taxpayer and his father were unfamiliar with the purpose and reasons for the various endorsements except that they did recognize that part of one endorsement was for the purpose of making the downward adjustment for profits from the Wold joint venture. (R. 39-40.)

At the time of the transaction and for some years prior thereto, taxpayer's father was not in good health and desired to bring taxpayer into the business. This matter had been the subject of discussions for some time between taxpayer and his parents and between his father and his mother. It was planned that taxpayer would first work in the business as an employee for a few years in order to determine whether he could undertake the rsponsibilities incident to partnership. Upon the establishment of his worth as an employee, his father then intended to offer him a partnership interest, which he did in 1943. (R. 40.)

The primary reason for having taxpayer execute the note at the time of the creation of the partnership was to fulfill his father's wish to deal fairly and equitably with both taxpayer and his sister, in so far as their destributive shares in their father's estate were concerned. It was intended that the balance remaining due on the note,

together with adjustments for gifts made by the father, was to be deducted from taxpayer's share in his father's estate in order to equalize the interest that taxpayer and his sister would receive upon their father's death. (R. 40.)

Taxpayer's share of the partnership business was not acquired by purchase. (R. 40.)

During 1943 taxpayer received from the partnership a drawing account of $200 per week, which represented a partial distribution of profits. He received no other profit distributions from the business in that year. (R. 41.)

During the taxable year taxpayer devoted all of his time to partnership business. His activities consisted principally of the supervision of the electrical house-wiring work of the Eddy Company, and the supervision of workers and the general management of some of the joint-venture activities. (R. 42.)

The reasonable value of taxpayer's personal services to the partnership in 1943 was $10,000, which is also a reasonable allowance as compensation for such personal services as he rendered to the business. (R. 42.)

On his 1943 tax return taxpayer reported total income for income tax purposes of $30,779.97, of which $30,258.37 was said to represent income from the partnership. He received salary and wages of $683.10 during the year and reported one-half thereof on his return. (R. 42.)

On his 1943 return, taxpayer also claimed a deduction for personal income tax payable to the State of California in the amount of $690.58 in computing income tax net income, and $688.45 in computing victory tax net income. In his notice of deficiency, the Commissioner allowed a deduction in the amount of $2,219.21 in the computation of income tax net income, but allowed no

deduction for the item in the computation of victory tax net income. (R. 43.)

On or about October 24, 1947, the office of the Franchise Tax Commissioner of the State of California sent taxpayer a formal notice of additional personal income tax proposed to be assessed, showing a proposed additional assessment in the amount of $1,484.51. Taxpayer duly filed with the Franchise Tax Commissioner a protest against the proposed additional assessment, contesting his liability for payment thereof. Taxpayer has not paid the proposed additional assessment and continues to contest his liability for the same. (R. 43-44.)

SUMMARY OF ARGUMENT

The Tax Court found that taxpayer did not receive his partnership interest from his father by way of purchase. This finding of fact, unless shown clearly erroneous by the taxpayer is binding upon this Court. Substance prevails over form in tax matters, and the Tax Court's conclusion that while the forms indicate a sale, the substance shows otherwise, is eminently correct.

Various circumstances indicate that, despite outward appearances, a sale was not intended—taxpayer was required to pay no interest on his promissory note nor was security required; neither taxpayer nor his father knew much of the details of the transaction by which taxpayer acquired an interest in the partnership; no adequate explanation was made of why payments on taxpayer's note to his father were not made; both partners placed extensive and somewhat vague reliance upon advice of counsel who attended to all details of the transaction; taxpayer's father really intended the outward manifestations of a sale as a protection to his daughter in the event of his decease, rather than as a bona fide sale.

For taxpayer to be entitled to deduct his California income taxes in computing victory net income the taxes

must be deductible under Section 23 (c) of the Internal Revenue Code and also incurred in connection with the carrying on of a trade or business. Like federal income taxes, taxpayer's state income taxes were a tax on personal income from the partnership. They were not taxes incurred because of partnership operations, but because of taxpayer's profit therefrom. They were, therefore, not incurred in the carrying on of a business.

ARGUMENT

I

The Tax Court's Finding that Taxpayer Did Not Receive His Share of the Partnership Business by Way of Purchase Was Not Clearly Erroneous and Therefore Binds this Court

The primary issue involved herein is whether taxpayer received his partnership interest from his father by way of sale or gift. If by sale, the taxpayer's partnership interest constitutes community property (California Civil Code (Chase, 1945), Sections 164, 687 (Appendix, *infra*)). But if the interest was acquired by gift from his father, then it is not community property but is the separate property of taxpayer (California Civil Code (Chase, 1945), Section 163 (Appendix, *infra*)), and income therefrom will be taxable, accordingly, entirely to him under Section 22 (a) of the Internal Revenue Code (Appendix, *infra*).

The Tax Court found that although the forms of a sale had been carried out, the transaction by which taxpayer acquired his partnership interest from his father was in substance a gift, in view of the circumstances involved. This finding is one of fact. *Manning* v. *Gagne,* 108 F. 2d 718 (C.A. 1st); *Smith* v. *Hoey* (S.D.N.Y), decided January 29, 1945 (34 A.F.T.R. 1704), affirmed, 153 F. 2d 846 (C.A. 2d). Accordingly, upon taxpayer falls the burden of proving the Tax Court's finding clearly erroneous, failing which it is conclusive upon this

Court. *Grace Bros.* v. *Commissioner,* 173 F. 2d 170 (C.A. 9th).

It is a familiar and basic rule of taxation that where form and substance conflict, substance prevails. *Gregory* v. *Helvering,* 293 U. S. 465. The form of words used and documentary recitals have no binding effect tested by what was in fact done. *Helvering* v. *Tex-Penn Co.,* 300 U. S. 481. Transactions between members of a family are peculiarly subject to the rule. Cf. *Commissioner* v. *Tower,* 327 U. S. 280; *Commissioner* v. *Culbertson,* 337 U. S. 733. It is clear that the Tax Court properly concluded that although the transaction herein between father and son, while formally a sale, was in fact and substance but a gift from father to son.

It would be virtually impossible to dignify the transaction as one at arm's length between taxpayer and his father, and therefore as a bona fide sale. As the Tax Court pointed out (R. 45):

> Such factors as the absence of interest, the vague and unexplained endorsements on the note, and the failure to make any payments on the note in the first few years, the only substantial offsets being in the form of gifts, undermine the result the petitioner wishes us to reach.

Not only did taxpayer allegedly purchase his partnership interest upon his non-interest-bearing note, the note was unsecured, and taxpayer stood but faintly behind it. He owned a small home, an automobile, and four shares of stock. (R. 38.) Taxpayer himself testified that he could not have borrowed $100,000 anywhere —save from his father—without paying interest. (R. 124.) It is dubious, with what security he could offer, whether he could have borrowed $100,000 anywhere else upon any terms. Taxpayer admitted that his arrangement with his father was "more than fair." (R. 124.)

There was, moreover, no consideration for the trans-

fer of partnership assets to taxpayer. His note was of no benefit to his father. Taxpayer was not obligated to pay anything to his father thereby, for the note provides (R. 57-58) that payment is to be made solely from expected annual profits of the partnership, solely, that is, from income which stems from the partnership interest taxpayer received from his father. In effect taxpayer pays to his father only that to which his father already had a right prior to the so-called sale. This is hardly a payment and connot be dignified as a consideration. The so-called promissory note is in substance more nearly a deed of gift than a promissory note. By the transaction taxpayer reseived a 50 percent interest in the assets of the partnership plus the right to share in 25 per cent of the partnership profits. His father retained a 50 percent interest in the assets of the partnership and *retained* the right to 75 percent of the profits. Taxpayer's credit is not truly pledged on the note, for failing profits from the partnership business he has no liability of payment thereon. There could be no default in payment without profits. Moreover, were the partnership to be dissolved, he would presumably have a right to his 50 percent share in the assets, whether payments had been made on the note or not. In such a situation, it is obvious that the Tax Court cannot be said to be clearly erroneous in concluding that there was no sale but merely a gift of taxpayer's partnership interest.

Taxpayer and his father knew little about the transaction. Taxpayer admitted that he knew practically nothing about the arrangements and depended upon his father and counsel. (R. 119-121, 124.) The entire deal was the creation of their attorneys. (R. 38, 72, 119, 139, 169-170, 172, 180, 196-197.) Both taxpayer and his father were at least vague, if not ignorant of endorsements made on the back of the note. (R. 39-40, 132-133, 134, 172-174, 175.)

Nor does taxpayer's explanation of why payments were not made out of profits seem satisfactory. Total profits for 1943, for example, were close to $120,000 (R. 125-126), out of which, according to the note, taxpayer would have been liable to pay his father $30,000. But no payments were made in that year. (R. 39, 126-127.) Taxpayer concedes that his case is weak in that payment was not made in the taxable year and some other years since he gave his note. (Br. 13.) No payments were made, upon advice of counsel, according to taxpayer's testimony (R. 126), and he *presumed* the reason for nonpayment to be the partnership's involvement in renegotiation proceedings. Some idea of the taxpayer's vagueness as to what went on can be gleaned from his testimony as to why no payments were made in 1943. Thus, he testified no payments were made because the partnership was under renegotiation and, further (R. 126-127)—

> Q. Did you talk that over with counsel?
> A. Yes, sir.
> Q. You, yourself, or did your father?
> A. Oh, Lord, I don't know.
> Q. You don't know?
> A. No, I don't.
> Q. Do you recall having a conversation with your father about whether or not you should make any payments?
> A. Well, we surely must have discussed it, or a payment would have been made, and I presume the reason for the payment not being made was that we were under renegotiation, and Mr. Smallpage was handling the renegotiation matters.
>
> * * * * *
>
> Q. When was all this renegotiation completed, do you recall?
> A. It was in the late spring or early summer of '43 or '44. '44, I believe.

Q. Yes. And was any attempt made at that time to make any adjustment on this note for the profits that you had received from the business in the preceding years?

A. No, sir.

Subsequently, taxpayer testified, things were again "in a turmoil" as a result of activity of the Internal Revenue Department (R. 127), but this hardly explains continued nonpayment on the note. The explanation seems even less convincing in view of the fact that even while matters were in a turmoil taxpayer's father saw fit to satisfy part of the obligation represented by the note by making gifts to taxpayer. (R. 39.) Moreover, as taxpayer points out (Br. 14), considerable time elapsed between the settlement of renegotiation proceedings and the commencement of Bureau investigation. The record also shows that no insistence was made that taxpayer pay up on his obligations under the note; that payments were apparently only made as the spirit moved taxpayer and his father; and that even while payments for some years were not made, allegedly because of confusion attending Bureau activity, payments were made for other years, just as taxpayer's father made gifts to him. (R. 176-181.) And yet, while taxpayer and his father testified many times that they were acting throughout on advice of counsel (R. 38, 72, 127, 132, 139, 169-170, 172, 180), these payments and gifts were made in the face of counsel's advice to "do nothing with the note" until the matters in turmoil might be straightened out (R. 177). Moreover, the fact that confusion attending Bureau investigation of partnership affairs had the effect of stopping payments on the note, as taxpayer and his father insist, lessens its effect as a bona fide and binding obligation. If the note were what it purported to be, payments should have been made on it regardless of Bureau activity, and not only on advice

of counsel. Both taxpayer and his father appear to have regarded all "these operations" (R. 196) most casually, and by no means in a manner suggesting that a real sale had been made.

Perhaps most important as an indication of the true intent of the parties in the transfer of the partnership interest to taxpayer lies in the reason behind it. As the Tax Court concluded (R. 46):

> When the transfer of the interest in the business was in reality a gift to the son in the nature of an advancement of an inheritance or legacy, a note was executed by the son, which was not intended by the parties to be evidence of a presently-enforceable debt arising out of a business transaction, but to be evidence of an advancement and which would serve as a means of equalizing, as between petitioner and his sister, the share of the father's estate which he would receive upon the latter's death.

Thus, taxpayer testified as to his father's intent when the alleged sale took place (R. 120):

> A. At the time he told me that he couldn't give me a half interest in the business because it would be unfair to my sister.
>
> Q. Yes.
>
> A. And that is why the promissory note was executed, and it was to be taken from my estate in the event of his death, in the event of his death I would have to pay back, I would have to pay back all the gift portion of that that had been assigned on the back of the note.
>
> Q. He said what?
>
> A. He said that any time—it would not be fair to my sister, he put this down advisedly, it would not be fair to my sister for him to give me a portion of the business, that I must purchase it.

(See also R. 122-123.) Had there been a bona fide sale, taxpayer's father would not need to have concerned himself with whether either his son or his daughter was

being preferred. Had there been a bona fide sale, the father's estate would have suffered no diminution, for the *forms* of the sale indicate full payment for value received.

In view of the foregoing, it cannot be said that the Tax Court's conclusion of fact that taxpayer did not receive his partnership interest by way of purchase is clearly erroneous. We submit that taxpayer has not borne his burden of proving the Tax Court wrong. He emphasizes in his brief the self-serving statements of the parties that a sale was intended but cannot overcome external circumstances upon which the Tax Court relied. And we submit that taxpayer's extensive quotations from the transcript (Br. 22-54) do not serve to show that the Tax Court's findings of fact were clearly erroneous.

II

The Tax Court Did Not Err in Denying Taxpayer a Deduction for His California Income Taxes

Taxpayer's second point of argument is that the Tax Court committed error in not allowing a deduction for state income taxes in computing his victory tax net income under Section 451 (a) (3) of the Internal Revenue Code (Appendix, *infra*). That section provides for the deduction of taxes to the extent that they are deductible under Section 23 (c) of the Internal Revenue Code (Appendix, *infra*) and, as a second condition, to the extent that the taxes are paid or incurred in connection with the carrying on of a trade or business.

The Tax Court has twice determined that state income taxes on individuals are not deductible within the meaning of Section 451 (a) (3). *Harris* v. *Commissioner,* 10 T.C. 818, affirmed without discussion of this point, 175 F. 2d 444 (C.A. 9th); *Whitman* v. *Commissioner,* 12 T.C. 324, affirmed without discussion of this point, December 22, 1949 (C.A. 2d). We submit that these deci-

sions are correct, and that the Tax Court did not err in its reliance upon the *Harris* case.

In enacting the provisions of Section 451 (a), the Committee on Finance (S. Rep. No. 1631, 77th Cong., 2d Sess., p. 8 (1942-2 Cum. Bull. 504, 509)) made the following significant comment in regard to it:

> Since the Victory tax does not allow any deduction for State income taxes, your committee deemed it advisable to provide that the total income tax and the Victory tax should not exceed 90 per cent of the taxpayer's net income.

Also see I.T. 3644, 1944 Cum. Bull. 372-373, in which it was held that personal income taxes are not deductible in computing victory tax net income under Section 451 (a).

As this Court undoubtedly knows, the California statute, under which taxpayer was liable for the taxes he seeks to deduct, is entitled "The Personal Income Tax" (3 Deering's California General Laws, Act 8494) and contains many provisions very similar to those found in the federal income tax law. This is particularly true as to the definitions of net and gross income and as to its treatment of partnerships. 3 Deering's California General Laws, *supra,* Sections 6, 7 and 22. Thus, it seems evident that the California income tax, like the federal income tax, is a personal income tax and is imposed on income from all sources. We submit, accordingly, that it is not a tax which is paid as an incident to carrying on a business and does not come within any of the provisions of Section 451 (a) above. We do not dispute, for the sake of the instant case, that taxpayer's California income taxes may be deductible under Section 23 (c).

Taxpayer argues (Br. 58-59) that his partnership income was business income, incurred in connection with the carrying on of a business. His argument depends upon the proposition that if there were no partnership business, there would be no income, and that the income

is therefore business income within the meaning of Section 451 (a), and also that he received income from a business. But the tax on taxpayer's personal income from the partnership business is not an incident of that business, and is not paid, we submit, in connection with the carrying on of the business. Accord, *Harris* v. *Commissioner, supra.* It is merely the tax on personal receipt of income. The tax is not imposed upon the business.

CONCLUSION

The decision of the Tax Court is in accordance with law and its findings are not clearly erroneous. Therefore, it should be affirmed.

Respectfully submitted,

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FEBRUARY, 1950.

APPENDIX

California Civil Code (Chase, 1945):

§ 163. *Separate Property of Husband.* — All property owned by the husband before marriage, and that acquired afterwards by gift, bequest, devise, or descent, with the rents, issues, and profits thereof, is his separate property.

§ 164. *Community Property. — Presumption from Mode of Acquisition.*—All other property acquired after marriage by either husband or wife, or both, including real property situated in this State and personal property wherever situated, heretofore or hereafter acquired while domiciled elsewhere, which would not have been the separate property of either if acquired while domociled in this State, is community property; * * *

§ 687. *Community Property Defined.*—Community property is property acquired by husband and wife, or either, during marriage, when not acquired as the separate property of either.

Internal Revenue Code:

SEC. 22. GROSS INCOME.

(a) *General Definition.*—"Gross income" includes gains, profits, and income derived from salaries, wages, or compensation for personal service * * * of whatever kind and in whatever form paid, or from professions, vocations, trades, businesses, commerce, or sales, or dealings in property whether real or personal, growing out of the ownership or use of or interest in such property; also from interest, rent, dividends, securities, or the transaction of any business carried on for gain or profit, or gains or profits and income derived from any source whatever. * * *

* * * * *

(26 U.S.C. 1946 ed., Sec. 22.)

SEC. 23. DEDUCTIONS FROM GROSS INCOME.

In computing net income there shall be allowed as deductions:

* * * * *

(c) [As amended by Sec. 202 of the Revenue Act of 1941, c. 412, 55 Stat. 687; Secs. 105, 122 and 158 of the Revenue Act of 1942, c. 619, 56 Stat. 798] *Taxes Generally.*—

(1) *Allowance in general.*—Taxes paid or accrued within the taxable year, except—

(A) Federal income taxes;

(B) war-profits and excess-profits taxes imposed by Title II of the Revenue Act of 1917, Title III of the Revenue Act of 1918, Title III of the Revenue Act of 1921, section 216 of the National Industrial Recovery Act, or section 702 of the Revenue Act of 1934, or Subchapter E of Chapter 2, or by any such provisions as amended or supplemented;

(C) income, war-profits, and excess-profits taxes imposed by the authority of any foreign country or possession of the United States, if the taxpayer chooses to take to any extent the benefits of section 131;

(D) estate, inheritance, legacy, succession, and gift taxes; and

(E) taxes assessed against local benefits of a kind tending to increase the value of the property assessed; but this paragraph shall not exclude the allowance as a deduction of so much of such taxes as is properly allocable to maintenance or interest charges.

(3) *Retail sales tax.*—In the case of a tax imposed by any State, Territory, District, or possession of the United States, or any political subdi-

vision thereof, upon persons engaged in selling tangible personal property at retail, which is measured by the gross sales price or the gross receipts from the sale or which is a stated sum per unit of such property sold, or upon persons engaged in furnishing services at retail, which is measured by the gross receipts for furnishing such services, if the amount of such tax is separately stated, then to the extent that the amount so stated is paid by the purchaser (otherwise than in connection with the purchaser's trade or business) to such person such amount shall be allowed as a deduction in computing the net income of such purchaser as if such amount constituted a tax imposed upon and paid by such purchaser.

* * * * *

(26 U.S.C. 1946 ed., Sec. 23.)

SEC. 451 [As added by Sec. 172 of the Revenue Act of 1942, c. 619, 56 Stat. 798]. VICTORY TAX NET INCOME.

(a) *Definition.*—The term "victory tax net income" in the case of any taxable year means (except as provided in subsection (c)) the gross income for such year (not including gain from the sale or exchange of capital assets as defined in section 117, or interest allowed as a credit against net income under section 25 (a)(1) and (2), or amounts received as compensation for injury or sickness which are included in gross income by reason of the exception contained in section 22 (b) (5)) minus the sum of the following deductions:

* * * * *

(3) *Taxes.*—Amounts allowable as a deduction by section 23 (c), to the extent such amounts are paid or incurred in connection with the carrying on of a trade or business, or in connection

with property used in the trade or business, or in connection with property held for the production of income.

* * * * *

(26 U.S.C. 1946 ed., Sec. 451.)

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